

Appeal from a decision of the Director, Minerals Management Service, denying refunds of rental payments. MMS-85-0339-OCS et al.

Affirmed.

1. Oil and Gas Leases: Rentals--Oil and Gas Leases: Royalties--Oil and Gas Leases: Unit and Cooperative Agreements--Outer Continental Shelf Lands Act: Unit Plans

The requirement set forth in a unit agreement to pay rental with respect to the nonparticipating acreage of unitized Outer Continental Shelf oil and gas leases but to pay minimum royalty with respect to the participating acreage does not effect a de facto segregation of such leases which would not be permitted in the absence of express statutory authorization.

2. Oil and Gas Leases: Rentals--Oil and Gas Leases: Unit and Cooperative Agreements--Outer Continental Shelf Lands Act: Refunds--Outer Continental Shelf Lands Act: Unit Plans

The Minerals Management Service properly denies a request for a refund of rental paid with respect to the nonparticipating acreage of unitized Outer Continental Shelf oil and gas leases where the unit agreement properly requires such payment consistent with the Outer Continental Shelf Lands Act, as amended, 43 U.S.C. || 1331-1356 (1982).

APPEARANCES: Michael E. Coney, Esq., Shell Offshore Inc., New Orleans, Louisiana, for appellant; Lawrence R. Hoese, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE KELLY

Shell Offshore Inc. (Shell) has appealed from a decision of the Director, Minerals Management Service (MMS), dated November 28, 1986, denying its appeals from six October 21, 1985, decisions of the Chief, Albuquerque Section, Lessee Contact Branch, MMS (MMS-85-0339-OCS through MMS-85-0344-OCS),

and ten June 24, 1986, decisions of the Chief, Solid Minerals Section, Lessee Contact Branch, MMS (MMS-86-0458-OCS through MMS-86-0467-OCS), denying its requests for refunds of rental payments made with respect to the nonparticipating acreage of various Outer Continental Shelf (OCS) oil and gas leases subject to certain Federal unit agreements.

This case involves various payments made by Shell for rental deemed by MMS to be due between May 1, 1982, and May 1, 1986, with respect to the nonparticipating acreage of various OCS oil and gas leases situated in the Mississippi Canyon Block 194 (No. 14-08-0001-16931), Galveston Block 288 (No. 14-08-0001-8670), High Island Block 160 (No. 14-08-0001-8666) and Vermilion Block 369 (No. 14-08-0001-16149) units located in the Gulf of Mexico, off the coast of Louisiana. ^{1/} The record indicates that at the time the payments were made the leases were in their extended term and were being held by production within the unitized areas.

By letters dated April 26 and 27, 1984, and January 16 and 24, and April 23 and 29, 1986, Shell requested that MMS refund the amount of the rental payments, generally asserting that Shell regarded the payments as "unnecessary" in view of the royalty payments already being made with respect to production attributable to the participating acreage of the units. Essentially, Shell argued that the requirement to make rental payments with respect to nonparticipating but not participating acreage constituted a segregation of the unitized leases contrary to Departmental authority, citing Solicitor's Opinion, 87 I.D. 616 (1980). The refund requests were made pursuant to section 10(a) of the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. | 1339(a) (1982).

In their October 21, 1985, and June 24, 1986, decisions, the Chiefs of the Albuquerque and Solid Minerals Sections, Lessee Contact Branch, denied Shell's refund requests, relying on an October 1, 1985, memorandum from the Assistant Solicitor, Offshore Minerals and International Law, to MMS, which addressed such requests. In that memorandum, the Assistant Solicitor concluded that the Solicitor's Opinion cited by Shell did not support the refunding of rental payments where, in connection with onshore oil and gas leasing on which offshore leasing was patterned, the requirement to make such payments with respect to nonparticipating but not participating acreage did not effect a segregation of unitized leases and Departmental regulations had long required such payments in any case.

On November 22, 1985, and July 24, 1986, Shell appealed the MMS decisions denying its refund requests to the Director, who consolidated the appeals for decision. Shell's principal contention was that the payment of rental with respect to the nonparticipating portion of a unitized lease was precluded by the fact that, in the case of unitization, production was

^{1/} The total amount of the payments was \$343,761. Of this, \$123,396 is attributable to the Mississippi Canyon Block 194 unit, \$103,140 to the Galveston Block 288 unit, \$89,100 to the High Island Block 160 unit, and \$28,125 to the Vermilion Block 369 unit.

attributable to all of the acreage in unitized leases, including nonparticipating acreage. Shell argued that production within the unitized area placed the entirety of such a committed lease into a production status in which no rental was due and that the payment of production royalty fulfilled the rental/minimum royalty payment requirement with respect to all of the unitized land, including the nonparticipating acreage. It argued that there was no statutory authority for the collection of rental in these circumstances. Moreover, Shell contended that to hold that the nonparticipating acreage was subject to the payment of rental would deny that acreage the benefit of such production and impose a separate burden on that acreage, thus effecting a segregation of the participating and nonparticipating portions of such leases, contrary to OCSLA and Departmental regulations as found in the Solicitor's Opinion. Also, Shell noted that the requirement to pay rental with respect to the nonparticipating acreage of unitized leases was not a longstanding practice of MMS and, in any case, was not the current practice of MMS.

In his November 1986 decision, the Director denied Shell's appeals, thus effectively denying its refund requests. The Director concluded that Shell was not entitled to a refund of the rental payments made with respect to the nonparticipating acreage of the unitized leases where Shell was contractually obligated to make such payments under the express terms of the subject unit agreements. Specifically, the Director referred to section 14.2(a) of the Mississippi Canyon Block 194 unit agreement which provides that, with respect to unitized leases, rental/minimum royalty payments shall be made on the following basis:

(a) An advance annual rental, equal to that amount called for in the individual leases, for each acre or fraction thereof, in no event creditable against production royalties, shall be paid for all Unitized Lands which are not within a Participating Area. (b) A minimum royalty, equal to that amount called for in the individual leases, shall accrue at the beginning of each lease year for each acre, or fraction thereof, for all Unitized Lands within a Participating Area as of the beginning of the lease year. [Emphasis added.]

Similar language, the Director noted, is contained in the other unit agreements. In addition, the Director held the fact that the current model unit agreement did not contain a requirement to make such payments did not entitle Shell to the retroactive rescission of the existing agreements or relief therefrom. Shell has appealed from the Director's November 1986 decision.

In its statement of reasons for appeal (SOR), appellant essentially reiterates the arguments advanced before the Director in support of its refund requests, contending that the payment of production royalty was sufficient to satisfy the rental/minimum royalty obligation with respect to all of the land within the unitized leases, including the nonparticipating acreage, and that to also require the payment of rental with respect to the nonparticipating acreage would effect an impermissible segregation of such leases. Moreover, appellant contends that any requirement to pay rental in

such circumstances contained in the subject unit agreements is in contravention of OCSLA and Departmental regulations and thus unenforceable. Therefore, appellant concludes that it is entitled to a refund of the rental paid with respect to the nonparticipating acreage of the unitized leases.

In its answer to appellant's SOR, MMS contends that the requirement set forth in the unit agreements to pay rental with respect to the nonparticipating but not the participating acreage of the unitized leases did not effect a segregation of such leases and was consistent with OCSLA and Departmental regulations even where production was occurring within the unitized area.

The principal issue in this case is whether, given such production and the payment of production royalty, MMS was entitled to also collect rental with respect to the nonparticipating acreage of the leases committed to those units. We conclude that MMS was entitled to collect rental with respect to the nonparticipating acreage of the unitized leases even where production was occurring within the unitized area and production royalty was being paid.

Appellant appears to confuse the situation here, where fully unitized leases are divided into participating and nonparticipating acreage, with the situation discussed in the Solicitor's Opinion cited by appellant, where leases only partially included in a unitized area and thus were broken down into unitized and non-unitized portions. In its SOR's both before the Director and the Board, Shell at numerous points characterizes the case as involving the payment of rental with respect to the non-unitized portions of unitized leases or lands lying outside the unitized area, rather than with respect to the nonparticipating acreage of unitized leases. Appellant appears to regard nonparticipating acreage as lying outside the unitized area. That is not an accurate impression. Moreover, the case simply does not involve leases which were only partially unitized. Nevertheless, based on this misimpression, appellant reaches the conclusion that treating the nonparticipating and participating acreage of unitized leases differently with respect to the obligation to pay rental/minimum royalty results in the impermissible segregation of the leases as found in the Solicitor's Opinion.

The Solicitor's Opinion stands for the proposition that it is improper for the Department to segregate the unitized and non-unitized portions of OCS leases only partially committed to a unit where OCSLA, unlike the Mineral Leasing Act, contains no express authority for such a "fundamental modification" of the original leasehold interest. 87 I.D. at 623. The Solicitor asserted that segregation would do more than merely impose an additional regulatory burden on the lessee, but rather would effectively rescind the original lease and create two new leases "with distinct requirements for rent, royalties, and the extent of production needed to prolong the secondary term of each segregated lease," which result could not be sanctioned in the absence of express statutory authorization. Id. Principally, the Solicitor noted that the segregation of partially committed leases would render the non-unitized portion no longer held by unit production. Id. at 619. He concluded that the proper approach in the absence of express authority for segregating partially committed leases was to regard both the unitized and non-unitized portions of such leases as one lease held by production anywhere within the unit.

There is, likewise, no express statutory authority for the segregation of fully unitized OCS leases by virtue of the designation of participating and nonparticipating areas of such leases and, therefore, no segregation can occur. Continental Oil Co., 70 I.D. 473 (1963). Appellant contends that treating these areas differently with respect to the requirement to pay rental/minimum royalty results in a de facto segregation. See SOR at 4. The question appellant raises, thus, is not whether a lease should properly be regarded as segregated and thus subject to different obligations as a result of partial unitization, as was the case in the Solicitor's Opinion, but rather whether the partial inclusion of a unitized lease in a participating area and thus the imposition of different obligations should be regarded as segregating the lease.

[1] It is clear, however, that designation of the participating and nonparticipating areas of a unitized lease does not amount to a segregation of the lease into "two new, distinct leases." 87 I.D. at 623. As set forth in the subject unit agreements, designation of a participating area within a unit only identifies which tracts of land and thus which leases or portions of leases committed to the unit participate in the allocation of unit production from within that participating area. Thus, designation of only a portion of a unitized lease as included within a participating area only affects the degree to which the lessee participates in the allocation of production. It does not itself fundamentally alter the leasehold interest by subjecting the lessee "to a different legal relationship from the one he originally entered into." Id.

Rather, any difference in the legal relationship originally entered into between the United States and the lessee occurs not as a result of designation of the participating area but rather as a result of the original commitment of the lease to the unit. As appellant notes, the leases involved herein provide that rental is payable up until the discovery of oil and gas on the leased area and that, thereafter, minimum royalty is payable. See 43 CFR 201.40 and .42 (19 FR 2663 (May 8, 1954)); Exh. 2 attached to appellant's SOR at 1. However, as MMS notes, unitization changes the lessee's rental/minimum royalty payment and other obligations. Section 17.2 of the Mississippi Canyon Block 194 unit agreement specifically provides that, by approving the agreement, the Oil and Gas Supervisor "does hereby establish, alter, suspend, change, or revoke the * * * rental, minimum royalty * * * requirements of the Federal leases committed hereto * * * to conform said requirements to the provisions of this Agreement." Identical language is contained in the other three unit agreements. Likewise, the subject unitized leases provide that the provisions of an applicable unit plan are to govern in the event of a conflict with the lease provisions. See Exh. 2 attached to appellant's SOR at 3.

As noted supra, the unit agreements require, after the discovery of oil and gas and designation of a participating area, the payment of an "advance annual rental" with respect to unitized land not within that area. In addition, the agreements require the payment of a minimum royalty with respect to land within the participating area. Thus, the effect of the unit agreements is to alter the rental/minimum royalty payment requirement set forth in the leases by requiring the payment of rental even after the discovery of

oil and gas in the case of a unitized lease partially included in a participating area. However, this modification of the lease relationship occurs as a direct result of commitment of the lease to the unit, and not because of designation of the participating area. Thus, we do not regard designation of a participating area as resulting in the de facto segregation of such unitized leases.

Moreover, we do not regard the fact that, as a result of unitization, the participating and nonparticipating areas of unitized leases are subject to different requirements regarding the payment of rental/minimum royalty as constituting a de facto segregation of such leases which must be expressly authorized by OCSLA. There is simply no "fundamental modification" of the original leasehold interest with respect to the payment of rental and royalty and, most importantly, the ability of production to extend the lease term, as would have been the case in the Solicitor's Opinion if the partial unitization was held to have resulted in a segregation. 87 I.D. at 623. The similarity with the present case extends only to the fact that the requirement to pay rental and royalty in the event of partial inclusion of a unitized lease in a participating area was altered by unitization. 2/ The entire lease, including the nonparticipating acreage, is held by production anywhere within the unit. That is clearly provided for in the subject unit agreements. The lessee thus still derives the prime benefit of production. Therefore, we do not regard the different requirements with respect solely to rental and royalty as constituting a de facto segregation as segregation is understood in the Solicitor's Opinion.

[2] In any case, we can find nothing in OCSLA or Departmental regulations which either expressly or implicitly contravenes the requirement contained in the subject unit agreements to pay rental with respect to the nonparticipating acreage of the unitized leases. Rather, we conclude that the authority set forth in section 5 of OCSLA, as amended, 43 U.S.C. | 1334 (1982), to prescribe necessary regulations adequately supports the requirement. As the Solicitor points out, the legislative history of OCSLA indicates that the Department was to have broad authority under this statutory

2/ In the present case, the practical effect of the alteration of the lease provisions regarding the payment of rental/minimum royalty was nil. Under the subject unitized leases, either rental or minimum royalty was payable with respect to all of the acreage within a lease depending upon whether there had been a discovery of oil or gas but, in either case, rental was payable at the same rate as minimum royalty. See Exh. 2 attached to appellant's SOR; Gulf Oil Corp., 21 IBLA 1, 2 (1975). Thus, after unitization, the total rental/minimum royalty charge in the case of a lease partially included within a participating area was the same as would have been the case under the leases where rental would be computed on the portion of the lease not within the participating area and minimum royalty would be computed on the remaining portion within that area. In the event of unit production, however, such a lessee would be required to pay production royalty in excess of the minimum royalty and, in addition, pay rental with respect to the nonparticipating acreage, whereas under the leases it would be required to pay only the production royalty. It is this to which appellant objects.

provision to adopt existing provisions of the Mineral Leasing Act with respect to such matters as unitization. See Solicitor's Opinion, 87 I.D. at 622-23.

At the time OCSLA was enacted in 1953, section 17 of the Mineral Leasing Act, as amended, 30 U.S.C. | 226 (1952), provided that "minimum royalty * * * under any lease that has become subject to any * * * unit plan of development or operation * * * shall be payable only with respect to the lands subject to such lease to which oil or gas shall be allocated under such plan." As noted in Solicitor's Opinion, M-36531 (Oct. 27, 1958), at 3, section 17 of the Mineral Leasing Act was interpreted by the Department to require the payment of minimum royalty "only [with respect to] those portions of unitized leases in a participating area," i.e., that area to which production is allocated under a unit agreement, with the "remainder of the unitized area * * * still in a rental status." See also Murphy Corp., 71 I.D. 233, 237 (1964). That interpretation was codified at the time of passage of OCSLA in Departmental regulation 43 CFR 192.80(b)(2) (1949) (most recently codified at 43 CFR 3103.2-2(i) (1987)), which, in such circumstances, required the payment of rental with respect to "lands not within the participating area." See also 43 CFR 3103.2-2(c) and 3-2(a) (53 FR 22838 (June 17, 1988)). The interpretation was also contained in applicable oil and gas leases. See Standard Oil Company of California v. Hickel, 317 F. Supp. 1192, 1193-94 (D. Alaska 1970), aff'd, 450 F.2d 493 (9th Cir. 1971); Piceance Partners, 82 IBLA 101 (1984); Dyco Petroleum Corp., 81 IBLA 65 (1984); Standard Oil Company of California, 5 IBLA 26, 79 I.D. 23 (1972).

The concept of charging rental with respect to the nonparticipating acreage of unitized leases was then carried over into the area of OCS oil and gas leasing by the subject unit agreements. See Rocky Mountain Mineral Law Foundation, Law of Federal Oil and Gas Leases | 12.03[5] (1986). From the earliest days, the Departmental regulation providing for the unitization of OCS lands has generally referenced the applicable regulations governing the unitization of lands subject to leasing under the Mineral Leasing Act. See 43 CFR 201.11 (19 FR 2662 (May 8, 1954)). Moreover, the subject unit agreements remain in effect and are binding on the parties thereto until modified or revoked with the approval of the Department. Aquarius Resources Corp., 64 IBLA 153 (1982); Marathon Oil Co., 16 IBLA 298, 81 I.D. 447 (1974); Shannon Oil Co., 62 I.D. 252, 255 (1955).

Furthermore, as MMS points out, the requirement to pay rental with respect to nonparticipating acreage has the advantage of encouraging the diligent development of the entire lease area short of segregating portions of that area for purposes of determining whether unit production extends the lease term, as generally sanctioned by the Solicitor's Opinion, 87 I.D. at 626. MMS cites Solicitor's Opinion, M-36531 (Oct. 27, 1958), at 2-3, to the effect that:

In a unit area rental is required to be paid by the lessees not only on any lease not within the participating area but also on any part of a lease not within such an area. It is not an operating charge. It is, in effect, a penalty payment required directly from the lessee for not operating or rather for not

completing a producing well either on the lease as an entirety or on the portion which does not participate. [Emphasis in original.]

The rental requirement operates as an incentive to develop nonparticipating acreage in order that such acreage can be brought within a participating area of the unit and thereafter be subject only to the payment of royalty. The latter opinion cited by MMS was directed to leases issued under the Mineral Leasing Act but is equally applicable in the context of OCSLA where the United States also has a interest in diligent development. See Solicitor's Opinion, 87 I.D. at 626-28.

Finally, we cannot conclude that the payment of production royalty with respect to production allocated to the participating acreage of a unitized lease satisfies the requirement in the subject unit agreements to also pay rental with respect to the nonparticipating acreage. In the case of unitization, production anywhere within the unit is attributable to any unitized lease for purposes of complying with the producing requirements and thus serves to extend the entirety of any such lease which is being held by production. However, it does not, contrary to appellant's assertion, thereby place the entirety of such a lease which is only partially included in a participating area in a producing status for purposes of the requirement to pay royalty where production is only allocated for such purposes to the tracts of land included in the participating area and where, in the absence of production, minimum royalty is payable with respect to only that land. 3/ Rather, the portion of the unitized lease not within the participating area is still expressly regarded by the unit agreements as subject to the separate requirement to pay rental. As the Solicitor stated in Solicitor's Opinion, M-36531 (Oct. 27, 1958), at 3: "The remainder of the unitized area is still in a rental status." This was echoed by the Solicitor in Solicitor's Opinion, 69 I.D. 110 (1962), wherein he noted that unitization does not make the leases committed to the unit "one for rental purposes." 4/ In

3/ Appellant purports to find support for its position that the entirety of a unitized lease partially included in a participating area is in a producing status following the initiation of production within the unit in an Apr. 25, 1985, letter to appellant from the Regional Supervisor (Exh. 5 attached to appellant's SOR), which stated that "the entire lease will be subject to minimum royalty after the date of contraction." See SOR at 5. However, appellant overlooks the fact that the contraction spoken of in the letter had the effect of rendering the unit area coextensive with the participating area. See Letter, dated Aug. 11, 1986, from appellant to MMS, at 3. Thus, the Regional Supervisor noted that contraction resulted in "no unitized land * * * extending outside the participating area." Id. In these circumstances, there simply was no nonparticipating acreage subject to the requirement to pay rental.

4/ This opinion overruled Solicitor's Opinion, M-36531 (Oct. 27, 1958), but did not disturb the conclusion that rental is properly charged with respect to the nonparticipating acreage of unitized leases. The Solicitor expressly recognized that: "There is no question that the rental requirements of unitized leases vary, depending upon whether or not they lie within a participating area." Solicitor's Opinion, 69 I.D. at 110.

addition, we note that to the extent the royalty and rental requirements apply to different portions of unitized leases partially included in a participating area, they are not duplicative.

Accordingly, we conclude that the Director in his November 1986 decision properly denied appellant's appeals, thereby effectively denying appellant's requests for the refund of rental paid with respect to the nonparticipating acreage of various unitized OCS leases committed to the four identified unit agreements.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

John H. Kelly
Administrative Judge

—

I concur:

Anita Vogt
Administrative Judge
Alternate Member